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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

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Arizona Corporation Commission

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AZ CORP COMMISSION  
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IN THE MATTER OF THE GENERIC  
PROCEEDINGS CONCERNING ELECTRIC  
RESTRUCTURING ISSUES.

Docket No. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC  
SERVICE COMPANY'S REQUEST FOR A  
VARIANCE OF CERTAIN REQUIREMENTS  
OF A.A.C. R14-2-1606.

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC  
PROCEEDING CONCERNING THE  
ARIZONA INDEPENDENT SCHEDULING  
ADMINISTRATOR.

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC  
POWER COMPANY'S APPLICATION FOR A  
VARIANCE OF CERTAIN ELECTRIC  
COMPETITION RULES COMPLIANCE  
DATES.

Docket No. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION  
OF TUCSON ELECTRIC POWER  
COMPANY FOR APPROVAL OF ITS  
STRANDED COST RECOVERY.

RUCO'S TRACK B REPLY BRIEF

Staff appears to doubt that its proposed solicitation process will produce desirable results in today's dysfunctional market. Staff's Initial Closing Brief at 7, citing Tr. at 111-112, 117-120, 298-299 (stating that markets are not workably competitive, lack a regional transmission organization, and rely on information that can be manipulated). Rather than adopting a process in which Staff lacks confidence, the Commission should include all

1 necessary consumer protections to ensure that a utility's choices of power supplies are the  
2 right ones in the first instance.

### 3 **A PRUDENT PROCESS MUST BE BASED ON LEAST-COST PRINCIPLES**

4       There is little debate that the utilities should procure a mix of resources that imposes the  
5 least cost on consumers. RUCO's Opening Brief at 2. As Staff says in its Initial Closing Brief,  
6 any "responsible utility should use least-cost planning principles to develop its overall portfolio."  
7 Staff Initial Closing Brief at 9. The procurement requires a least-cost planning analysis (i.e.,  
8 system modeling of resource options to determine the mix that results in the lowest present  
9 value of revenue requirements), whether by a utility on its own when evaluating bids, or in a  
10 more formal proceeding before the Commission to review the prudence of the utility's selection  
11 process.

### 12 **SOLICITATION MUST RESULT IN SAVINGS TO RATEPAYERS**

13       Staff correctly recognizes that the Track B solicitation must yield cost savings to  
14 ratepayers (Staff's Initial Closing Brief at 2). Staff, however, does not identify a baseline for  
15 measuring such savings. Only RUCO has addressed that question.

16       The utilities should evaluate the merchants' bids against a baseline of the regulated cost  
17 of service for providing new generation resources of the same type. Exh. RUCO-1 at 23  
18 (Rosen). To make this evaluation, utilities must provide "proxy" bids for the new generation  
19 resources. The utilities should reject as imprudent market bids that exceed the potential  
20 regulated cost of service. The utility should use the remaining market-based bids to acquire  
21 the mix of merchant-bid resources that result in the least cost to consumers. If the remaining  
22 bids do not fill the utility's unmet needs, the utility should acquire the mix of merchant-bid and  
23 utility self-build resources that will result in the least cost to consumers.

1 Modeling the dispatch of the electrical system not only helps to determine the least-cost  
2 mix of resources, but also addresses many of the other issues raised in this proceeding. Exh.  
3 RUCO-2 at 1 (Rosen). For example, rather than deciding precisely how much capacity and  
4 energy must be solicited, the Commission can allow bidders to bid any amounts of capacity  
5 and energy that they desire. Exh. RUCO-1 at 39 (Rosen). The utility's system analysis of the  
6 resulting bids will identify the least-cost mix of resources to meet load. Exh. RUCO-2 at 3  
7 (Rosen); Tr. at 736 (Rosen).

8 Likewise, the Commission need not determine how much reliability must-run ("RMR")  
9 capacity to include in contestable load. A least-cost planning analysis that correctly models all  
10 relevant transmission constraints will determine the optimum portfolio of resources over all  
11 hours in the year. The RMR and non-RMR needs must be evaluated simultaneously, because  
12 the least-cost RMR and non-RMR portfolios will affect one another. Since consumers pay for  
13 both, they must be evaluated together.

14 The utilities should acquire resources for only one year's capacity growth (2003) if a  
15 proper least-cost planning process, including demand-side management ("DSM") options,  
16 does not allow enough time to acquire resources for this summer. Tr. at 751 (Rosen).  
17 Procuring for more than one year's growth would be imprudent absent a least-cost plan. The  
18 utilities could conduct a more fully developed solicitation for 2004-2006.

19 **THE SOLICITATION RESULTS SHOULD NOT JEOPARDIZE THE STATUS OF EXISTING**  
20 **UTILITY PLANTS IN RATE BASE**

21 APS is concerned that a dispute over contestable load might lead to generation assets  
22 in rate base no longer qualifying for rate base treatment if other resources replace their  
23 capacity and energy. However, RUCO does not believe that any generation assets already in  
24 the retail rate base should be removed from rate base as a result of the Track B solicitation. A

1 bidder is not likely to offer capacity and energy at a lower cost than the utilities' energy costs  
2 for an existing generating unit. Exh. APS-5 at 16 (Carlson). However, if a utility accepted such  
3 a bid, the plant's capacity would still be available for service to the utility's customers. The  
4 utility plant should remain in rate base, although not providing as much energy as before,  
5 because the Commission had previously deemed the plant's capacity to be prudent for the  
6 long term.

#### 7 **THERE IS ROOM FOR AUCTIONS IN THE SOLICITATION PROCESS**

8 Reliant has proposed conducting an auction for at least one-third of the capacity  
9 solicited, as if this could be done "outside" of a least-cost analysis. This proposal is flawed  
10 because an auction will not tell us whether the winning auction bids can fit within a least cost  
11 portfolio of resources. Only the system dispatch model can provide the proper answer. Exh.  
12 RUCO-2 at 6-7 (Rosen). An auction can be a step in the overall least-cost planning process,  
13 but cannot substitute for that process.

#### 14 **CONCLUSION**

15 Given the state of the wholesale power market, the Commission cannot have  
16 confidence that market-based bids will save customers money compared to utility-owned  
17 generation. The utilities must offer proxy bids for regulated generation as a hedge against  
18 potentially higher costs from the market.

19 Traditional least-cost planning principles are essential. System dispatch modeling,  
20 including the modeling of the transmission constraints, can resolve many of the issues in  
21 dispute, and can determine the mix of both RMR and non-RMR resources that results in the  
22 least-cost power to consumers. A comparable consideration of DSM programs is needed to  
23 round out a prudent power purchasing process.

24

1 RESPECTFULLY SUBMITTED this 31st day of December, 2002.

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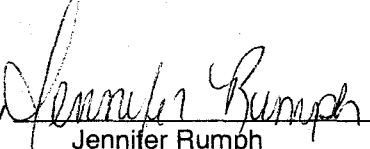
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